No. 92-1384

IN THE

SUPREME COURT OF THE UNITED STATES

October Term 1992

BARCLAYS BANK PLC

Petitioner,

v

FRANCHISE TAX BOARD,
AN AGENCY OF THE STATE OF CALIFORNIA

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE COURT APPEAL OF THE STATE OF
CALIFORNIA IN AND FOR THE THIRD
APPELLATE DISTRICT

BRIEF OF ORGANIZATION FOR INTERNATIONAL INVESTMENT INC. AND UNION OF INDUSTRIAL AND EMPLOYERS' CONFEDERATIONS OF EUROPE AS *AMICI CURIAE* IN SUPPORT OF *CERTIORARI*

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INTEREST OF AMICI CURIAE

The Organization for International Investment Inc. ("OFII") is a non-profit corporation the members of which are United States subsidiaries of foreign

shareholders.[1] The Union of Industrial and Employers' Confederations of Europe ("UNICE") is recognized as the official spokesman for European business and industry vis-a-vis the European Economic Community and other European institutions.[2]

OFII members are domestic companies engaged in manufacturing, distributing goods, and performing services within the United States. OFII members export manufactured and processed goods and import various articles. OFII represents members' interests in matters of federal and State taxation and seeks legislative and judicial solutions to problems affecting economic interests of its members. OFII members have a direct and vital interest in the international aspects of the tax issues presented by this case. Similarly to the petitioners, OFII members bear an increased and discriminatory tax burden under California law. OFII members are treated as unitary with their foreign affiliated companies and are obliged to pay California taxes on foreign source income of companies that do not do business anywhere in the United States. California's scheme of worldwide taxation creates a substantial impediment to international commerce and to investment in the United States by foreign persons.

The member federations of UNICE are the official representatives of all sectors of business and industry in their respective nations. UNICE comprises thirty-three member federations from twenty-two European nations including all European Community and European Free Trade Association nations. UNICE's permanent secretariat is in Brussels, Belgium. An important objective of UNICE is to promote international commerce and investment by eliminating international double taxation. UNICE views California's taxation of foreign source income of companies that do not do business in the United States as a direct impediment to the flow of capital and intellectual

1. A list of OFII members in annexed as Appendix I. Neither the petitioner nor any of its subsidiaries and affiliates are members of OFII.

2. A list of UNICE organizations is annexed as Appendix II.

property between the United States and the nations UNICE represents. UNICE is particularly concerned with the chilling effect the extra-territorial reach of California's unique tax method has on foreign direct investment in the United States.

OFII and UNICE believe it is essential that the United States speak with "one voice" in international taxation matters, as required by this Court's decision in *Japan Line Ltd. v County of Los Angeles*.[3] Departure from *Japan Line* principles poses a severe risk of burdensome and unfair international multiple taxation. The inherent incompatibility between California's worldwide combined reporting method and the internationally accepted arm's length standard inevitably leads to multiple taxation of enterprises represented by the *amici* organizations.

SUMMARY STATEMENT

The Barclays Bank PLC Petition for a Writ of Certiorari seeks review of a decision of the Supreme Court of California that directly confronts the power of the Federal Executive in matters of foreign commerce and taxation of international transactions. In all of its tax treaties and in the Internal Revenue Code, the United States has promoted and adhered to the internationally accepted standard of arm's length, separate entity accounting for division of taxable income by multinational entities. California has expanded its unitary income apportionment method of taxation to include foreign transactions and foreign entities over which neither California nor the United States has jurisdiction. These disparate methods cannot be reconciled. California's disregard of international and federal sourcing-of-income rules inevitably creates a substantial risk of multiple taxation; imposes severe compliance burdens that interfere with the free flow of commerce; and intrudes upon the prerogatives of the federal government in foreign affairs and international commerce. The United States cannot conduct a coherent

3. 441 U.S. 434 (1979).

foreign economic policy — that is, it cannot speak with "one voice" — in the face of a disparate and incompatible income tax method applied internationally by individual States.

The overriding issue in this case is whether the dormant Commerce Clause requires that California's worldwide combined reporting tax regime be restricted to *interstate commerce* where its principles were developed. That issue has not been decided by this Court in the context of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries. This issue was specifically reserved for decision by this Court in *Container Corp. of America v Franchise Tax Bd.*[4] This case now presents the issue with unusual clarity and, therefore, should be heard by this Court.

In its strained reading of *Wardair Canada Inc. v Florida Dep't of Revenue*,[5] the California Supreme Court has advanced a novel analysis of the dormant Commerce Clause that elevates Congressional inaction to Congressional mandate. If the California judgment is allowed to stand, any State may establish policy affecting foreign commerce of the United States and even contravene federal foreign policy with impunity unless and until interdicted by an act of Congress. The California Supreme Court's decision disregards this Court's precedents and endeavors to supersede federal foreign policy. This Court should grant the petition in this case to settle finally the dormant Commerce Clause issue that has been open for ten years since the decision in *Container Corp.*

STATEMENT OF REASONS FOR TAKING THE CASE

A. THE DECISION BELOW IMPAIRS THE FEDERAL GOVERNMENT'S ABILITY TO CONDUCT FOREIGN RELATIONS.

4. 463 U.S. 159 (1983).
5. 477 U.S. 1 (1986).

The United States adopted the arm's length method many years ago as its standard for allocating income among commonly controlled corporations doing business in more than one nation.[6] This method is reflected in the Internal Revenue Code[7] and is embodied in all bilateral tax treaties to which the United States is a party.[8] The arm's length standard, moreover, is accepted by foreign nations: no foreign nation uses worldwide combined reporting.

No one questions that worldwide combined reporting for tax purposes is incompatible with the arm's length method. The question is whether the United States can maintain and administer uniform standards to divide income among nations if those standards are ignored by individual States. The application of worldwide combined reporting to international commerce by California "... impair[s] the ability of the federal government to carry out its tax and investment policy in the international area" and "has seriously complicated [the United States'] economic relations with many of our closest allies."[9] Its use has been a matter of extreme concern to the United States' trading partners and has already led to harm to the United States as a nation.[10]

The reason for the United States to observe and assure compliance with the international standard is twofold: (1) to secure uniform and equitable treatment of United States business abroad and, correspondingly, (2) to

6. E.g., FOREIGN INVESTOR'S TAX ACT, Pub. L. No. 89-809, 80 Stat. 1539 (1966).

7. See I.R.C. § 482 and the income sourcing rules of I.R.C. Subchapter N, §§ 861 — 65.

8. These numerous authorities are collected in the *amicus* brief of the United States filed in the court below, reproduced in Petitioner's appendix at H-10,n.5.

9. Letter to Governor Deukmijian of California, dated Jan. 30, 1986, from Secretary of State George P. Schultz, included in Appendix A of the *amicus curiae* brief of the United States, reproduced in Petitioner's Appendix at H-43.

10. Letter of 30 June 1989, on behalf of the European Community, delivered to the Secretary of State by the Spanish Ambassador, annexed as Appendix IV.

protect as agreed by treaty foreign direct investment in the United States. Neither objective is attainable if a major commercial jurisdiction within the United States ignores the international standard and subjects foreign direct investments to what amounts to economic harassment through double taxation and imposition of excessive compliance costs.

The lower courts that considered this case found on the basis of substantial evidence that California's use of worldwide combined reporting, as applied to foreign-owned corporate groups, violated the Foreign Commerce Clause because it "impair[ed] federal uniformity in an area where federal uniformity is essential" and "prevent[ed] the Federal Government from speaking with one voice when regulating commercial relations with foreign governments."[11]

The precise legal issue presented by this case is whether the United States foreign policy "voice" as expressed by the Executive Branch, combined with Congressional assent in the form of enabling legislation and treaty ratification, is sufficient to invoke the protection of the Foreign Commerce Clause of the United States Constitution for the beneficiaries of that foreign policy.[12]

B. THE DECISION BELOW IS MATERIALLY IN CONFLICT WITH PRIOR DECISIONS OF THIS COURT REGARDING THE DORMANT COMMERCE CLAUSE.

The California Supreme Court has effectively declined to consider the Foreign Commerce Clause issues raised by this case. The California Court chose not to follow the dormant Commerce Clause analysis developed by this Court in *Container Corp.* and *Japan Line*, but,

11. *Japan Line*, 441 U.S. at 448, 451 (citation omitted).

12. This is frequently referred to as the "dormant" Commerce Clause issue. *Franchise Tax Bd. of Cal. v Alcan Aluminium Ltd.*, 493 U.S. 331, 334-35, specifically referred to *Container Corp.* and *Japan Line* as the controlling authorities.

rather, chose to read *Wardair* as a blanket permit removing the State's tax method from scrutiny in the absence of Congressional action expressly forbidding use of the method. This clearly contravenes views recently expressed by this Court in striking down a State tax exclusively levied on foreign dividends.[13]

The distinction between a tax on a "discrete transaction occurring within the State" and one on foreign commerce itself has been carefully restated by this Court in *Itel Containers Int'l Corp. v Huddleston*.[14] The *Itel* opinion's reference to *Wardair*[15] in this context lends no support to the California Supreme Court's convoluted analysis. The *Itel* opinion, indeed, expressly reaffirmed the principles of *Complete Auto Transit, Inc. v Brady*[16] and *Japan Line*, and endorsed the analytical process of *Container*. In view of this recent expression of the appropriate tests to be applied, the California Supreme Court's attempt to postulate a new test for the Commerce Clause based on an unwarranted distortion of *Wardair* is all the more untenable. The opinion below ignores altogether this Court's admonition that "Congress must manifest its unambiguous intent before a federal statute will be read to permit or approve ... [violations] of the Commerce Clause ...."[17] There is, to be sure, nothing in *Wardair* that suggests Congressional silence becomes an endorsement of State action that violates Complete *Auto Transit* and *Japan Line* principles. The court below created a departure from those principles and simply cited the result in *Wardair* as supportive of that departure. No other court has been able

13. *See Kraft General Foods, Inc. v Iowa Dep't of Revenue and Finance*, ____ U.S. ____, 112 S. Ct. 2365 (1992). The dissent, moreover, noted that the case did *not* involve a foreign entity and that the Executive Branch actually *supported* the State's power to levy the tax. It may be surmised, therefore, that both the majority and the dissent would have viewed the instant case more favorably to petitioners.

14. ____ U.S. ____, 113 S. Ct. 1095, 1104 (1993).

15. *Supra*, n. 5.

16. 430 U.S. 274 (1977).

17. *State of Wyoming v State of Oklahoma*, ____ *U.S.* ____, 112 *S.* Ct. 789, 802 (1992).

to discern such a departure in the *Wardair* opinion.[18]

What the California Supreme court chose not to acknowledge was that there was nothing in the facts of *Wardair* that called for dormant Commerce Clause analysis. Congress had expressly permitted the States to levy sales taxes on fuel purchased within their borders. The question in *Wardair* was whether certain international conventions and resolutions modified this clear policy in the case of international flights. This Court found that no such policy could be discerned and, hence, declined to engage in a *Japan Line* style of Commerce Clause analysis. From this rather clear doctrine, the California Supreme Court has posited a wholly new principle: Congressional inaction on a specific issue must be deemed Congressional endorsement of the State's action irrespective of Executive foreign policy. This new principle purportedly would apply here regardless of the obvious conflict with the Internal Revenue Code and the principles found in tax treaties to which the United States is a party. It would also apply regardless of the adverse effect the State's policy may have on the foreign commerce of the United States. This "principle," which effectively stands dormant Commerce Clause analysis on its head, can only be characterized as a perversion of *Wardair*, not an application of it.

This case now comes before this Court after eight and one-half years of litigation on these Foreign Commerce Clause issues in the California court system.[19] It may be anticipated that the respondent, Franchise Tax Board, will urge this Court *not* to address the important foreign commerce issues posed by California's application of worldwide combined reporting in this case and similar cases. The respondent will argue that there is no conflicting federal foreign policy or interference with international

18. This includes the two lower California courts that considered this issue and were unimpressed by the respondent's arguments concerning *Wardair*. See Petitioner's Appendix at A-31, 32 and B-13, 14.

19. Five of those years were spent in the appellate process. The petitioners herein filed their complaint in Superior Court on 30 November 1984. The trial court filed its decision on 20 August 1987.

commerce of the United States to be addressed. But the Foreign Commerce Clause issue presented by this case is too important to be delayed any longer.[20] Worldwide combined reporting continues to interfere with United States foreign policy, to offend the United States' trading partners, and to undercut important federal economic policies. The decision of the California Supreme Court is so patently inconsistent with this Court's prior decisions that it should not be allowed to continue to cast a shadow over the foreign relations and foreign commerce of the United States.

CONCLUSION

For the reasons stated, *amici curiae*, Organization For International Investment and Union of Industrial and Employers' Confederations of Europe, urge this Court to grant the Petition for a Writ of Certiorari.

Respectfully submitted,

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20. The respondent, Franchise Tax Board, has managed to avoid a decision on the merits of the foreign commerce issue for more than ten years in both State and federal courts. See, *e.g.*, *Capitol Indus. — EMI, Inc. v Bennett*, 681 F.2d 1107 (9th Cir.), *cert. denied*, 459 U.S. 1087 (1982); *Shell Petroleum, N.V. v Graves*, 570 F. Supp. 58 (N.D. Cal.), *aff'd*, 709 F.2d 593 (9th Cir.), *cert. denied sub nom. Shell Petroleum N.V. v Franchetti*, 464 U.S. 1012 (1983); *Alcan Aluminium Supra*, n.12. This is the first case in which a foreign parent corporation has been able to claim standing in California courts as a "taxpayer." The California Supreme Court previously has declined to hear cases involving State and local taxation of foreign commerce. Both *Japan Line* and *Container Corp.* were appeals from lower California courts.

APPENDICES

APPENDIX I

ORGANIZATION FOR INTERNATIONAL INVESTMENT INC.

CORPORATE MEMBERS

AKZO AMERICA, INC.
ALCAN ALUMINUM CORPORATION
ALCATEL USA CORPORATION
ASEA BROWN BOVERI, INC.
BASF CORPORATION
BATUS INC.
BET INC.
BP AMERICA CORPORATION
BTR, INC.
BUMBLE BEE SEAFOODS, INC.
BUNGE CORPORATION
CENTRAL SOYA COMPANY, INC.
CIBA-GEIGY CORPORATION
ELF AQUITAINE, INC.
FINA OIL & CHEMICAL CO.
FIREMAN'S FUND INSURANCE COMPANY
GLAXO INC.
GRAND METROPOLITAN INCORPORATED
GUINNESS AMERICA, INC.
HANSON INDUSTRIES
HITACHI, LTD.
HOECHST CELANESE CORPORATION
HOFFMANN-LA ROCHE, INC.
ICI AMERICAS INC.
INSTORIA, INC.
KLOCKNER NAMASCO CORPORATION
LVMH MOET HENNESSY LOUIS VUITTON
MATSUSHITA ELECTRIC CORPORATION OF AMERICA
MINORCO (USA) INC.
NESTLE USA, INC.
NORTH AMERICAN PHILIPS CORPORATION
PEARSON INC.
PECHINEY CORPORATION
PILKINGTON HOLDINGS, INC.
RANK AMERICA, INC.
REED PUBLISHING (USA) INC.
RHONE-POULENC

ROLEX WATCH, U.S.A., INC.
ROLLS-ROYCE INC.
RTZ AMERICA
SANDOZ CORPORATION
SCHINDLER ELEVATOR CORPORATION
S.G. WARBURG & CO. INC.
SIEMENS CORPORATION
SKF USA, INC.
SMITHKLINE BEECHAM
SONY CORPORATION OF AMERICA
SOUTHLAND CORPORATION
TETRA LAVAL
THORN EMI NORTH AMERICA HOLDING, INC.
TOYOTA MOTOR SALES, U.S.A., INC.
UNILEVER UNITED STATES, INC.

APPENDIX II
UNICE MEMBERS

Federation des Entreprises de Belgique (Belgium)
Danish Employers' Confederation (Denmark)
Federation of Danish Industries (Denmark)
Conseil National du Patronat Français (France)
Bundesvereinigung der Deutschen Arbeitgeberverbände — BDA (Germany)
Bundesverband der Deutschen Industrie — EDI (Germany)
Federation of Greek Industries (Greece)
Confederazione of Irish Industry — CII (Ireland)
Federation of Irish Employers — FIE (Ireland)
Confederation Generale dell' Industria Italiana — CONFINDUSTRIA (Italy)
Federation des Industriels Luxembourgeois (Luxembourg)
Verbond van Nederlandse Ondernemingen — VNO (Netherlands)
Nederlands Christelijk Werkgeversverbond — NCW (Netherlands)
Confederacion Espanola de Organizaciones Empresariales — CEOE (Spain)
Associaçao Industrial Portuguesa — AIP (Portugal)
Confederaçao da Industria Portuguesa — CIP (Portugal)
Confederation of British Industry — CBI (United Kingdom)
Vereinigung Osterreichischer Industrieler — VOI (Austria)
Confederation of Finnish Industries (Finland)
Finnish Employers' Confederation (Finland)
Federation of Icelandic Industries (Iceland)
Confederation of Icelandic Employers (Iceland)
Confederation of Norwegian Business and Industry (Norway)
Swedish Employers' Confederation (Sweden)
Federation of Swedish Industries (Sweden)

"Vorort" de l'Union Suisse du Commerce et de l'Industrie (Switzerland)
Union Centrale des Associations Patrocales Suisses (Switzerland)
Turkish Industrialists' and Businessmen's Association — TUSIAD (Turkey)
Turkish Confederation of Employer Associations — TISK (Turkey)
Employers & Industrialists Federation Cyprus (Cyprus)
Malta Federation of Industry — MFOI (Malta)
Associazione Nazionale dell'Industria Sammarinese (San Marino)

APPENDIX III

Letter From the European Community To The United States Government.

EL EMBAJADOR de ESPAŃ
WASHINGTON
June 30th, 1989

The Honorable
James A. Baker, III
Secretary of State
U.S. Department of State
Washington, D.C. 2520

Dear Sir:

The Member States of the European Community have noted that the United States Supreme Court is shortly to hear an appeal against the judgement of the Seventh Circuit Court of Appeals in Imperial Chemical Industries plc [sic] and Alcan Aluminium Limited v. California Franchise Tax Board.

The EC Member States consider this to be an appropriate opportunity to restate their opposition to the use of worldwide unitary tax by the State of California. They would urge the United States Government to confirm that, like the previous Administration they, too, are opposed to the use of worldwide unitary tax.

The views of the EC Member States on worldwide unitary tax are well known.* They consider that the imposition of this tax is inconsistent with the internationally accepted principles underlying the Tax Treaties and Friendship Treaties that individual Member States have entered into with the United States. Specifically, the use of the tax by the State of California:

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*Demarche of the EC Member States submitted to the U.S. Department of State; 19 March, 1980; 30 October, 1981; 29 June 1982; 1 August, 1983; 23 September, 1983; 20 December, 1984, 8 August, 1985; 30 August, 1985.

i) contradicts the "arm's length" principal of allocating income of multi-national corporations between different national jurisdictions;

ii) may give rise to substantial double taxation;

iii) imposes a severe compliance burden by insisting on the restatement of accounts of different, but affiliated, corporations throughout the world even when they are not doing any business in California — accounts which were originally prepared to meet the specifications of the countries in which these corporations are resident;

iv) has perverse effects on the worldwide strategy of multi-national corporations (since, for example, a cost saving investment made in any country outside the U.S., can increase the tax liability in California, even if the California subsidiary is loss-making);

v) discriminates against companies doing business in California via subsidiaries, rather than through non-affiliated companies.

The EC Member States are strongly opposed to the attempt by California or any other State to impose taxation in income of foreign corporations arising outside the U.S.; to interfere with worldwide investment strategies, and to insist on burdensome compliance requirements on companies located outside the U.S.

EC Member States are aware that California has amended its legislation to allow multi-national companies to elect, on payment of a fee, to be taxed on a "water's edge", rather than worldwide unitary basis. However, since they are opposed to the use of worldwide unitary tax in principle, Member States cannot accept that it is right to insist on a fee as the price for electing to avoid worldwide unitary tax. Moreover, the process of making such an election involves substantial and unreasonable burdensome compliance costs.

The EC Member States, of course, support the case submitted by Imperial Chemical Industries and by Alcan Aluminum in the District Court and the Seventh Circuit Court of Appeal. They also very much endorse the *amicus* brief submitted by the U.S. in the District Court in ICI and Alcan v. California FTB. The EC Member States are aware that the issue currently before the Supreme Court is the question of the standing of the foreign parent companies to challenge the tax in the Federal courts, rather than the constitutionality of the tax itself. However, they believe the two issues to be inextricably interlinked. The EC Member States consider that worldwide unitary tax imposes an administrative and economic burden on foreign parent corporations and breaches the arm's length standard. Since the U.S. in its double taxation convention adheres to the internationally accepted arm's length principle, application of worldwide unitary tax by separate states of the U.S. prevents the U.S. from speaking with one voice when regulating commercial relations with foreign governments, and in the opinion of EC Member States is unconstitutional. The administrative and economic burden is imposed directly on foreign corporate parents and it is this constitutionally significant burden which creates standing for those foreign parents.

The Member States note and appreciate the U.S. Government's opposition to worldwide unitary tax. Given the importance of the present case before the Supreme Court, the Member States would urge the U.S. Government to reaffirm their commitment to the position taken by the previous Administration.

Sincerely,

/s/ Julian Santamaria

Julian Santamaria
Ambassador of Spain